As I see

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THE EFFECT OF THE ELECTION ON REAL ESTATE

IT is hoped that with the election of General Eisenhower, the 20-year domination of the Federal government by planned economists who believe in a strong central government will come to a close. I am not certain, however, that this will be the case.

I have no question of General Eisenhower's sincerity, nor of the desire of the Republican Party to return, insofar as possible, to an economy of private enterprise, where the profit and loss incentives are the dominant factors relied upon to provide a constantly expanding standard of living. I also have complete faith in the fact that these motives are almost entirely responsible for the fact that the United States in the last 150 years has outrun all other countries of the world, and has produced a higher average standard of living for its people than has ever been attained by any other nation in history.

My doubts arise from the fact that we all realize that the Republican Party is on trial. It has been accused of causing the Great Depression of the thirties. Should a new depression of any size develop during the tenure of General Eisenhower, the Republicans will go out in disgrace four years from now, in spite of the fact that the depression may be the natural aftermath of the unwise policies followed during the past 20 years. Our present boom has been kept going by borrowing from the future and by inflating our currency and credit. To continue this policy is hazardous, but even though it be continued, the longer it lasts, the less effective it will be. Continued doses of inflation must constantly get stronger in order to be effective.

General Eisenhower is not an economist and will necessarily have to take his ideas on economic policies from others. As a successful general, however, it goes without saying that he is a realist, and it seems to me that very early in his Presidential career he is going to be faced with the alternatives of continuing inflationary measures or of allowing the long-delayed adjustment to take place.

Whether he wishes to or not, I see no way in which he can avoid a rather definitely inflationary procedure. During 1953 it will be necessary to refund practically $1 billion per week of the national debt, as bond maturities will come due at approximately that rate. It will be impossible to sell long-term govern-

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REAL ESTATE ECONOMISTS, APPRAISERS AND COUNSELORS

ments in any quantity to the large life insurance companies, as these companies have been reducing their holdings of governments since 1946. The 60 largest life insurance companies in the United States shrank their government bond portfolios from approximately $12.5 billion to $10 billion from 1950 to 1951. When the total bondholdings of the 60 largest life insurance companies total only $10 billion, it is ridiculous to assume that refunding operations of $1 billion a week can be helped very much by purchases of long-term governments from this source. Neither can we expect individuals to absorb large amounts, as the sale of E bonds and other types sold to the general public in recent years has not been sufficient to offset the maturities of the same type of bond. This leaves the government probably just one possible course of action - to issue these bonds for short and intermediate terms and to make them acceptable investments for banks.

The purchase of government bonds by the banks is equivalent to increasing the volume of currency and credit and, in my opinion, is inferior to the printing of greenbacks. The great advantage of the printing of greenbacks would be that the general public would be greatly alarmed and would insist on a retarding of the presses, but the selling of bonds to the banks and its effect on the credit and currency of the country is not generally understood, and for that reason causes no alarm. It seems to me that even though we operate on a balanced budget from here on out, the refunding of this debt will have an inflationary effect on our economy.

In many of the other policies of the Federal government, General Eisenhower will also find that the momentum of the past is so strong that the trends we have been developing during the past 20 years cannot be changed suddenly without grave danger of precipitating in a rather harsh manner the adjustments in our economy which are long overdue.

Government policies could be developed which would avoid both booms and depressions, and would enable our economy as a whole to go forward without these violent disturbances, but I am confident that the best way to prevent a depression is to prevent the preceding boom, and the avoidance of booms will be more or less impossible so long as governments are run by human beings. Even after business has reached boom proportions, delegations of citizens trek to Washington to ask for the passage of additional legislation which will increase the volume still further.

One of the best controls of the business cycle is the interest rate. The interest rate should rise in boom periods and should fall in depression periods. As the interest rate rises in a boom period, it becomes less profitable to speculate and expand, and the amount of speculation is contracted. On the other hand, during a period of poor business, if the interest rate is low, it becomes possible to borrow at low rates of interest to make capital investments, and the activity generated in this manner helps to stabilize the economy.

All during the period of the Roosevelt and Truman Administrations, every effort was made to lower interest rates, and up to the present time both the FHA and the Veterans Administration have refused to recognize the fact that interest rates

have risen. No market exists in the United States for VA loans at 100. A larger and larger percentage of loans other than veterans' loans are passing from the FHA-insured type to conventional loans because of the continued attempt to hold interest rates below the level which they have reached at the present time.

We have seen the same struggle between the Treasury Department and the Federal Reserve. In spite of the boom characteristics of the market, the Treasury has constantly insisted on a policy of low interest rates because of the size of the government debt. Fortunately, the Federal Reserve Board won in its attempt to enforce a more realistic policy and, with the unpegging of government bonds, the interest rate has risen.

Had the interest rate risen some years ago, there would be an opportunity in the period ahead to lower the interest rate in order to stimulate business in a lagging market. This, like many other inflation-control tools, has been worn down to the handle trying to make the boom bigger and is, accordingly, more or less useless now that it may be necessary to stimulate the general economy.

Even though economists find that the general economic level can be stabilized and that general booms and depressions which affect all industries can be avoided, it will never be possible to avoid good and bad times in individual industries. A rise in price, for instance, in the real estate field is an indication of shortage. The rise in price stimulates new construction, and since the construction industry is as large as it is, also contributes greatly to a boom in general business. The continuation of a construction boom, however, gradually fills the shortage which existed and builds an oversupply. Until the oversupply grows to the point where rents and values drop, it is still profitable to build, and the building boom continues. When the oversupply brings on a readjustment in the real estate field, the industrial activity which was concentrated on new construction is automatically directed into more profitable channels. This same principle holds in all other industries but, because oversupplies and shortages can correct each other more quickly, the swings in other lines of business are not so long nor so extreme as they are in the real estate field.

One of the effects of the election is almost certain to be the removal of almost all price, wage and rent controls not later than this next spring. The conservative element in Congress has long wished to do away with many of these controls, realizing that we were treating symptoms and not causes, but all possible Administration propaganda and pressure were turned both on the public and on Congress to continue the controls. This pressure will now be lacking, and I am confident that a more conservative administration and a more conservative Congress will allow controls to lapse.

Do not expect too much, however, from a dropping of rent controls. Those properties which were frozen far below the market will see an increase in rents, but it is my opinion that the average of all rents paid in the community will not increase during the next few years by so great a percentage as is generally ex-

pected. I have been watching for a number of years the behavior of rents in cities which were freed from control. The higher-priced units in cities formerly under rent control will be rented with greater and greater difficulty, and many of the newer units which were built at high costs will find it necessary to reduce the allowed rental schedules to an amount below the level for which these properties were renting a year or so ago.

It is not my present opinion that an immediate collapse in real estate values is imminent. Our figures would indicate that residential properties have increased in value even from 1951 to 1952, and our studies of the past would indicate that no great collapse will come in residential values until the construction cost of new buildings has started dropping. During the past year, construction costs have been fairly stable, and certainly any very sizable drop in construction costs is still some time away.

As a policy, I would recommend the selling of the less desirable pieces of real estate and the reduction in mortgage on better quality pieces. In other words, I believe that now is the time to be conservative. Slim equities and heavy mortgages were extremely desirable in the late thirties and early forties to make the maximum profit. Conservation of principal should now be a dominant motive on the part of investors.

If we were on the gold standard, I would certainly favor the conversion of real estate into cash and bonds, in spite of the capital gains tax. In view of our managed currency (which, if the economic history of the world is worth anything at all, will be mismanaged, with the dollar losing still further in its purchasing power), it seems to me that a good piece of real estate is a tangible investment which should surpass in quality many other types of investments during the next 10 to 20 years.

During the trying years ahead, it will be of the utmost importance for all persons who believe in private enterprise to do everything which can be done to help the Administration maintain business on as even a keel as possible. Whether, however, a sizable readjustment from the recklessly inflationary policies of the past can be avoided, is yet to be seen. The policy I am advocating for real estate will be a good policy if a readjustment comes. If, on the other hand, we are able to avoid a readjustment period, it will still be a policy not quite so profitable as a more speculative one, but providing a conservative income with a minimum of risk and worry.

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